

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18032374
Z. NI AND)
J. QIAN)
_____)

OPINION

Representing the Parties:

For Appellants: Z. Ni
J. Qian

For Respondent: David Muradyan, Tax Counsel III

For Office of Tax Appeals: Andrea Long, Tax Counsel

J. MARGOLIS, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Z. Ni and J. Qian (respectively, Ni and Qian; collectively, appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing \$781 of additional tax for their 2014 tax year.¹

Appellants waived their right to an oral hearing, and therefore this matter is being decided based on the written record.

ISSUE

Whether appellants have shown error in the proposed assessment of additional tax, which is based on federal adjustments made by the Internal Revenue Service (IRS).

¹ After the filing of this appeal, appellants submitted a check payable to FTB to the Office of Tax Appeals (OTA) in payment of the proposed deficiency, and OTA forwarded appellants' check to FTB.

FACTUAL FINDINGS

1. Appellants filed a timely 2014 joint California income tax return (Form 540).
2. During 2014, Qian made two \$5,500 contributions to a traditional individual retirement account (IRA) maintained by Vanguard Fiduciary Trust Co. (Vanguard) as trustee of the plan. Appellants did not claim IRA deductions for either of the \$5,500 contributions.
3. The first \$5,500 contribution was made on March 31, 2014; it was designated as a contribution for 2013. The day after the contribution was made, the amount contributed, plus \$35.03 of earnings thereon, was distributed to Qian's Roth IRA account, also maintained by Vanguard.
4. The second \$5,500 contribution was made on June 23, 2014; it was designated as a contribution for 2014. Approximately two weeks after the contribution was made, the amount contributed, plus \$3.06 of earnings thereon, was distributed to Qian's Roth IRA account at Vanguard.
5. Qian's traditional IRA account at Vanguard contained no assets before the above-mentioned contributions. It contained no assets after those contributions, together with the earnings thereon, were distributed to Qian's Roth IRA account.
6. FTB received information from the IRS indicating that it had adjusted appellants' federal income tax liability for 2014. The IRS determined that the \$11,038.09 distributed from Qian's traditional IRA account to Qian's Roth IRA account constituted taxable IRA distributions, and increased appellants' 2014 income by that amount. The IRS also disallowed a miscellaneous itemized deduction of \$221.² The IRS adjustments resulted in a federal income tax deficiency for 2014 that was assessed on June 27, 2016.
7. Based on the federal adjustments, FTB made corresponding adjustments to appellants' 2014 California tax liability. FTB issued a Notice of Proposed Assessment (NPA) to appellants on April 20, 2017. It determined that the federal adjustments generated additional state tax of \$781, plus interest.³

² The precise nature of the \$221 disallowance is not clear from the record. Appellants, however, have not contested this disallowance.

³ The NPA increased appellants' taxable income by \$11,921, from \$228,303 to \$240,224. The increase in taxable income was calculated based on \$11,038 of unreported pension income (i.e., the distributions from traditional IRA account to the Roth IRA account), \$221 of disallowed miscellaneous deductions, and a \$662 computational disallowance of itemized deductions on account of the increase in appellants' adjusted gross income.

8. Appellants timely protested FTB's NPA. In their protest, appellants alleged that the IRS's determination of unreported income was erroneous, and that they were in "discussion/argument with IRS about this item" and expected the IRS to reverse its determination. Appellants asked that FTB place their protest on hold while the IRS was considering appellants' position.
9. FTB agreed to withhold action on appellants' protest temporarily, until December 11, 2017. Because FTB did not receive further information from appellants indicating any change in the federal determination by that date, it issued a Notice of Action (NOA) to appellants affirming the NPA on January 9, 2018.
10. Appellants timely filed this appeal from the NOA.
11. After the appeal was filed, OTA wrote to the parties, noting that "our research suggests that [under Internal Revenue Code (IRC) section 408(d)(4)] if a taxpayer did not claim a deduction for the original contribution to a traditional IRA, then the conversion of the contributed amount into a Roth IRA will not be taxable (except to the extent that earnings on the contributed amount are distributed)," and requesting that appellants provide additional briefing and documentation as to whether they had claimed IRA deductions for the IRA contributions they made in 2014. In response to OTA's request, appellants provided copies of their 2013 and 2014 tax returns, which showed that they had not claimed IRA deductions for those years. OTA then wrote to FTB offering it the opportunity to respond to appellants' new information. FTB filed no response.

DISCUSSION

R&TC section 18622(a) provides that taxpayers shall either concede the accuracy of a federal determination or state wherein it is erroneous. A federal determination is deemed final when the adjustment resulting from an IRS examination is assessed. (R&TC, § 18622(d); IRC, § 6203.) The IRS determination upon which FTB's determination is based has become final.

It is well settled that taxpayers bear the burden of proving, by a preponderance of the evidence, that a deficiency assessment based on a final federal determination is erroneous.⁴

⁴ A "preponderance of the evidence" means that the taxpayer must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.)

(*Appeal of Brockett* (86-SBE-109) 1986 WL 22731.) Unsupported assertions are insufficient to satisfy the taxpayers' burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

Although appellants have not shown that the IRS has reversed its determination, they have provided evidence that sustains their burden of proving that the IRS determination, as it relates to the IRA distributions, was, more likely than not, incorrect. Appellants have shown that the amounts the IRS determined to be taxable IRA pension distributions to Qian were primarily transfers of amounts of undeducted contributions to Qian's traditional IRA account that were transferred to Qian's Roth IRA account.⁵ Although qualified retirement contributions to a traditional IRA account typically are tax deductible (see IRC, § 219(a)), that is not inevitably the case, and various limitations may apply to restrict or completely eliminate a taxpayer's ability to deduct contributions to a traditional IRA (see, e.g., IRC, § 219(g)). Appellants attached Forms 5329 to their 2013 and 2014 returns showing that the two \$5,500 contributions Qian had made to a traditional IRA account each year were "excess contributions," and that no IRA deduction was claimed for either contribution.

When a nondeductible contribution is made to an IRA, the taxpayer is required to file an IRS Form 8606 (entitled "Nondeductible IRAs") with his or her return. That form assists taxpayers and taxing agencies in recordkeeping so that the nontaxable portion of any subsequent IRA account withdrawal or distribution can be ascertained. Although appellants did not file Forms 8606 with respect to the contributions at issue, nothing in the statutory scheme or relevant case law suggests that a taxpayer who has failed to comply with this reporting requirement cannot use other evidence to show that he or she did not claim an IRA deduction for a contribution in determining the tax consequences of a withdrawal or distribution of the amount contributed.

IRC section 408, to which California law generally conforms (see R&TC, § 17501), governs the tax consequences of distributions from IRAs. IRC section 408(d)(1) states that distributions from a traditional IRA generally are included in a taxpayer's gross income. Furthermore, when funds are transferred from a traditional IRA to a Roth IRA, the transferred amount "is includible in gross income as a distribution according to the rules of IRC section 408(d)(1) and (2) for the taxable year in which the amount is distributed or transferred from the traditional IRA." (Treas. Reg. § 1.408A-4, Q&A-7; see also IRC,

⁵ Contributions to a Roth IRA account are not deductible. (IRC, § 408A(c)(1).)

§ 408A(d)(3)(C).) However, there is an exception to this rule for situations where, as is the case here, no deduction was allowed for the amounts distributed from the traditional IRA. That exception is set forth in IRC section 408(d), which provides, in pertinent part, as follows:

(d) Tax treatment of distributions.

- (1) In general. Except as otherwise provided in this subsection, any amount paid or distributed out of an individual retirement plan shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

* * *

- (4) *Contributions returned before due date of return. Paragraph (1) does not apply to the distribution of any contribution paid during a taxable year to an individual retirement account or for an individual retirement annuity if—*

(A) such distribution is received on or before the day prescribed by law (including extensions of time) for filing such individual's return for such taxable year,

(B) no deduction is allowed under section 219 with respect to such contribution, and

(C) such distribution is accompanied by the amount of net income attributable to such contribution.

In the case of such a distribution, for purposes of section 61, any net income described in subparagraph (C) shall be deemed to have been earned and receivable in the taxable year in which such contribution is made. [Italics added.]

Appellants have shown that the distributions out of Qian's traditional IRA account were made prior to the due dates of appellants' returns for 2013 and 2014, and that those distributions consisted entirely of Qian's undeducted contributions to a traditional IRA account and the earnings thereon. Thus, those distributions come within the ambit of IRC section 408(d)(4), and only the \$38.09 of earnings that were distributed constitutes taxable income to appellants.

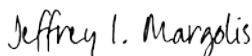
HOLDING

Only \$38.09 of the \$11,038.09 of distributions from Qian's traditional IRA account constitute taxable income to appellants.

DISPOSITION

FTB's determination that appellants had additional income of \$11,038.09 in 2014 is reversed; only \$38.09 of that amount constitutes taxable income to appellants. The uncontested aspects of FTB's determination (the minor adjustments to appellants' itemized deductions) are sustained.

DocuSigned by:



Jeffrey I. Margolis
Administrative Law Judge

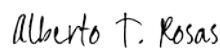
We concur:

DocuSigned by:



Andrew J. Kwee
Administrative Law Judge

DocuSigned by:



Alberto T. Rosas
Administrative Law Judge

Date Issued: 4/21/2020